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April 10, 1997

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW, Room 222
Washington, D.C. 20554

VIA FEDERAL EXPRESS

**Re: Small Cable Business Association; Petition for Partial Reconsideration;
CS Docket No. 96-60**

Dear Mr. Caton:

We enclose for filing in CS Docket No. 96-60 the attached Petition for Partial Reconsideration. We have enclosed the originals and eleven copies of each for distribution. We also enclose one copy of each that we ask that you return to us in the enclosed envelope after they have been stamped "Received".

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Mr. William F. Caton
April 10, 1997
Page 2

We also include a copy of the documents on disk.

If you have any questions or need additional information, please contact us.

Very truly yours,

HOWARD & HOWARD



Christopher C. Cinnamon

Enclosures

cc: Chairman Reed Hundt
Commissioner James H. Quello
Commissioner Rachelle B. Chong
Commissioner Susan Ness
Meredith Jones
John E. Logan
William Johnson
Rick Chessan
David D. Kinley
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CERTIFICATE OF SERVICE

I, Lisa Sheesley, a secretary at the law firm of Howard & Howard Attorneys, P.C., declare that the Petition for Partial Reconsideration filed on behalf of the Small Cable Business Association in CS Docket No. 96-60, was sent on the 10th day of April, 1997 via Federal Express to:

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW
Washington, D.C. 20554

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and that in a second Federal Express envelope eight individual envelopes were sent, each containing a copy of the above-referred to document and a copy of the April 10, 1997 letter directed to Mr. Caton. The eight envelopes were addressed as follows:

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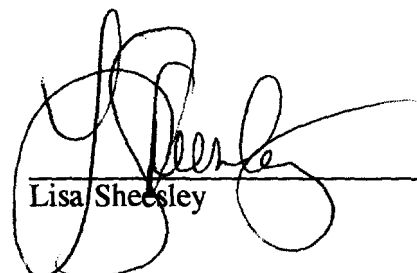
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Dated: April 10, 1997



Lisa Sheesley

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)

Implementation of Sections of the)
Cable Television Consumer Protection)
and Competition Act of 1992)
Rate Regulation)

Leased Commercial Access)

Second Report and Order and Second)
Order on Reconsideration)

CS Docket No. 96-60

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SMALL CABLE BUSINESS ASSOCIATION
PETITION FOR PARTIAL RECONSIDERATION

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April 10, 1997

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SUMMARY

Throughout this rulemaking, SCBA has raised the critical small cable issue of transaction costs arising from leased access transactions. The *Second Order on Reconsideration* dispatched this issue with a sentence in the Final Regulatory Flexibility Analysis. The Commission should reconsider its analysis. If the Commission does not permit qualifying small systems to require reimbursement of leased access transaction costs, small cable and its customers will be forced to subsidize leased access users.

SCBA seeks reconsideration of the Commission's denial of a transaction cost reimbursement provision for small systems. As described in this Petition, leased access transaction costs will rise under the new average implicit fee formula. At the same time, maximum permissible leased access rates have substantially declined. As the Commission has recognized, small cable does not have the administrative and financial resources to bear the same compliance burdens and costs imposed on larger systems. As a result, the new leased access rules will lead to squeezed margins, higher rates or both. This will adversely impact small cable's ability to grow and develop cable systems, contrary to the purpose of 47 U.S.C. § 532.

SCBA proposes an adjustment to 47 C.F.R. § 76.971 that will address this issue. The adjustment will permit qualifying small systems to require reimbursement of reasonable leased access transaction costs. Leased access users can use existing procedures to challenge unreasonable requests for reimbursement. This provision will provide both leased access users and small systems with incentives to minimize transaction costs and reach standardized, balanced agreements.

If the Commission does not permit small systems to recover reasonable transactions costs, it must adjust the average implicit fee formula for small systems. Without such an adjustment, the formula will result in rates that do not fully compensate small systems for the value of their channels and the costs of leased access compliance.

I. INTRODUCTION

The Small Cable Business Association (SCBA) submitted comprehensive comments¹ in response to *Reconsideration Order and Further Notice*.² In its comments, SCBA explained how the Commission's proposed leased access rules would impose unintended and disparate administrative burdens and costs on small cable operators. SCBA also proposed alternatives to the proposed rules that would lessen the administrative burdens and costs on small cable. The Commission listened. In the *Second Order on Reconsideration*,³ the Commission made several adjustments to its proposed rules to ameliorate some of the impact of those changes on small cable.

SCBA returns to the Commission on one critical small cable issue - leased access transaction costs. Leased access transaction costs may seem routine business expenses for larger operators. But these costs from leased access transactions will impose inordinately high per subscriber costs on small systems. Prohibiting small cable operators from recovering reasonable transaction costs will foist these costs on small cable operators and their customers. This will either squeeze small cable's margins, drive up rates, or, most

¹ See, Comments of SCBA, filed May 15, 1996; Comments of SCBA regarding the Initial Regulatory Flexibility Act Analysis, filed May 15, 1996; Information Collection Comments of SCBA, filed May 15, 1996; and Reply Comments of SCBA, filed May 31, 1996.

² *Order on Reconsideration of the First Report and Order and Further Notice of Proposed Rulemaking*, MM Docket 92-266/CS Docket No. 96-60, FCC 96-122 (released March 29, 1996) ("*Reconsideration Order and Further Notice*").

³ *Second Report and Order and Second Order on Reconsideration of the First Report and Order*, CS Docket NO. 96-60, FCC 97-27 (released February 4, 1997) ("*Second Order on Reconsideration*").

likely, both. These results conflict with the statutory mandate that leased access rules should remain consistent with the growth and development of cable systems, including small cable systems.⁴

For these reasons, SCBA must seek reconsideration of the Commission's small system transaction cost recovery prohibition. SCBA asks the Commission to adjust its rules to permit qualifying small cable systems to require reimbursement of reasonable transaction costs.

II. THE COMMISSION MUST ALLOW QUALIFYING SMALL SYSTEMS TO RECOVER LEASED ACCESS TRANSACTION COSTS.

A. Negotiating and documenting leased access contracts will impose high per subscriber costs on small cable.

Under the revised leased access rules, leased access transaction costs will increase. Previously, small cable operators had little or no leased access activity.⁵ The new average implicit fee formula will increase demand for leased access by lowering its cost.⁶ Now, small cable systems will need to negotiate and document many leased access agreements. These will represent new and costly transactions for small operators. Higher transaction costs will mount from the costs of outside counsel, consultants and, in some cases, the costs of one or more additional full or part-time employees serving as leased access coordinators.

Most SCBA members must retain outside counsel for nonroutine transactions,

⁴ 47 U.S.C. § 532(a).

⁵ See, SCBA Comment, p. 24 ("A recent SCBA member survey demonstrated that most SCBA members had not received a single leased access inquiry over the past five years").

⁶ *Second Order on Reconsideration*, ¶ 35 ("We believe that a shift from a highest implicit fee formula to an average implicit fee formula may provide additional opportunities for diverse, unaffiliated programmers to enter the marketplace . . .").

especially highly regulated transactions like leased access. SCBA estimates that negotiation and documentation of full-channel, full-time leased access arrangements will involve between 10 and 20 hours of attorney time. At an average hourly rate for outside counsel of \$150, out-of-pocket costs could range between \$1,500 and \$3,000 per contract, with an average of \$2,000.

Costs for small systems will not differ significantly if the leased access administration were brought in-house. SCBA estimates that a leased access administrator would be paid at least \$26,000.⁷ Assuming a single headend system that receives one request for part-time carriage per week, the cost of the in-house administrator would be \$500 per leased access request. Additionally, most leased access programmers use either in-house or outside counsel to negotiate and document their agreements. Consequently, most small cable companies will still need to involve outside counsel to advise the leased access administrator. SCBA estimates that outside counsel involvement for a typical agreement would likely remain at least 5 to 10 hours. At \$150 per hour, the total cost of outside counsel remains \$750 to \$1,500. This coupled with the cost of the in-house administrator results in a total transaction cost of \$1,250 to \$2,000.

For a large system, \$2,000 per full-time contract may seem a de minimis cost of doing business. For smaller systems, however, high per subscriber costs will result. Consider the following table:

⁷ SCBA members generally pay administrative level employees approximately \$20,000 and benefits totaling another 30% (\$6,000).

Distribution Of \$2,000 Per Transaction Cost	
System Subscribers	Cost Per Subscriber
100	\$20.00
250	\$ 8.00
500	\$ 4.00
1,000	\$ 2.00
10,000	\$ 0.20

Transaction costs escalate geometrically when part-time carriage is considered. Part-time carriage, especially for one-time showings of programs, can result in multiple leased access agreements for a single day. If an operator received even one part-time request for leased access carriage per week, transaction costs could reach \$104,000 annually. Such costs will financially bury many small systems. Rate increases could alleviate the bind, but this would shift leased access costs to customers. The table below shows the inequity of making small systems and their customers bear this leased access cost:

Distribution Of \$104,000 Annual Cumulative Transaction Cost	
System Subscribers	Cost Per Subscriber
100	\$1,040.00
250	\$ 416.00
500	\$ 208.00
1,000	\$ 104.00
10,000	\$ 10.40

In many markets, small cable cannot raise rates to cover leased access transaction costs. DBS and other competitors, who have no leased access obligations, are exerting

downward pressure on rates. The only remaining source of paying for leased access transaction costs is the small operator's bottom line. This will undercut the ability to upgrade systems, improve services and attract capital, the same problems small cable faced from rate regulation before the *Small System Order*.⁸

The Commission has understood this small cable problem in the context of rate regulation. In establishing Form 1230 relief for small cable, the Commission found:

[T]he comments indicate that smaller cable companies are unduly burdened by the current scheme of rate regulation in two ways. First, the comments suggest that our rate rules do not adequately take into account the higher costs of doing business, and particularly the higher costs of capital, faced by smaller companies. Second, many operators claim that our rules place an inordinate hardship upon them in terms of the labor and other resources that must be devoted to ensuring compliance.⁹

The same analysis that led to Form 1230 regulatory relief supports permitting small systems to include reasonable transaction costs involved arising from leased access compliance. Failure to do so will impede small cable system's ability to grow, develop and compete. This conflicts with the purpose of leased access.

In enacting mandatory leased access for certain systems, Congress explicitly stated that the implementation of the leased access requirements should not adversely affect the economic position of cable operators:

The Committee's overriding goal in adopting this section is divorcing cable operator editorial control over a limited number of channels. In doing so, the Committee does not intend to adversely affect the cable operator's economic position, since it is not the cable operator's exercise of any economic power,

⁸ *Sixth Report and Order and Eleventh Order on Reconsideration*, MM Docket Nos. 92-66, 93-215, FCC 95-196 (released June 5, 1995) ("*Small System Order*").

⁹ *Small System Order*, ¶ 55 (emphasis added).

but his exercise of editorial control, which is of concern to the Committee If not properly implemented, leased access requirements could adversely impact the economic viability of a cable system, thereby hurting the public.¹⁰

For the over 600 small cable operators subject to the leased access set-aside, the Commissions' transaction costs restriction will produce precisely the result Congress sought to avoid. The Commission has ample experience and an extensive record on the disparate regulatory burdens with which small cable must contend. The Commission should draw on that experience in reconsidering its leased access rules.

As discussed below, the Commission did not fully analyze the adverse impact of its revised rules on the growth and development of small cable systems.

B. The *Second Order on Reconsideration* failed to address the impact of transaction costs on small cable.

In its comments, SCBA sought a presumption that small operator's could include at least \$1000 of transaction costs per leased access contract.¹¹ The *Second Order on Reconsideration* dismissed this request in its Final Regulatory Flexibility Analysis:

We do not agree with SCBA that small system operators should be allowed to include in their rates an additional sum of at least \$1,000 as compensation for transaction costs imposed by leased access because, as discussed in Section II.B.2.c., we believe that the recovery that operators may gain from subscriber revenue for leased access programming will sufficiently offset any additional transaction costs.¹²

Essentially, the Commission orders a "one size fits all" transaction cost rule. The

¹⁰ Joint Committee Report on the Cable Communications Policy Act of 1984, House Report No. 93-934 (*"1984 Joint Committee Report"*), 51.

¹¹ SCBA Comments, p. 18.

¹² *Second Order on Reconsideration*, ¶ 158 (emphasis added).

Commission presumes that the average implicit fee formula, a formula for *lower* leased access rates, will somehow result in sufficient revenue to cover *increased* transaction costs.

For small systems, this rule fails for two reasons. First, it overlooks the high per subscriber cost that leased access transactions will impose on small systems. This average implicit fee formula makes no adjustment for small systems' higher cost structures and limited administrative resources. Second, back in Section II.B.2.c., the Commission recognizes that cable operators will *not* recover many transactions costs:

In addition, we believe that subscriber revenue from a leased access channel will be further offset by lost advertising revenues since leased access programmers, unlike other programmers, generally will not provide advertising slots to the cable operator. Subscriber revenue will also be offset by additional administrative costs imposed by leasing, which are not recovered through the average implicit fee formula.¹³

Large systems may absorb these costs as de minimis costs of doing business. Small cable cannot. As recognized by the Commission, the economies of scale and administrative resources do not exist for small systems.¹⁴ So the "additional administrative costs imposed by leasing, which are not recovered through the average implicit fee formula," will hit small cable especially hard.

The more limited channel capacity of most small cable systems exacerbates the problem. For many small systems, leased access users will bump existing programming. Consequently, either through going-forward rules or through Form 1230 rate regulation,

¹³ *Id.*, ¶ 43.

¹⁴ *Small System Order*, ¶ 55.

most small operators will not be able to raise rates for adding leased access programming on regulated tiers. Competitive pressures in many markets will not allow increases in unregulated rates either, especially for programming that customers value less. The Commission expressly acknowledges this:

Based on what cable operators in a competitive environment are able to charge subscribers for the addition of a new channel, our "going forward" order allows operators to charge a subscriber \$0.20 a month for an additional channel. We expect, however, that operators will recover less than \$0.20 for a new leased access channel because we believe that, on average, subscribers will not be willing to pay as much for new leased access programming as they do for new programming selected by the cable operator.

* * *

Additional factors are likely to further reduce any potential excess recovery. For one, the "going forward" rate is based on what operators can charge subscribers when new channels are added without displacing existing programming. Therefore, if leased access programming displaces existing programming, any amount of subscriber revenue that an operator gains from a leased access channel may be offset by subscriber revenue lost from the displaced channel.¹⁵

In other words, for small systems, the potential to recover the high per subscriber transaction costs from subscriber revenues does not exist under the average implicit fee formula.

The limited discussion of the transaction cost issue in the Final Regulatory Flexibility Analysis misses these key points.¹⁶ Elsewhere, the Commission concludes that the average implicit fee formula will increase demand, bump existing programming and reduce operator revenues. Consequently, no revenue source exists under the new rules to pay for leased

¹⁵ *Second Order on Reconsideration*, ¶¶ 42, 43 (emphasis added).

¹⁶ *Id.*, ¶ 158.

access transactions costs incurred by small systems. Contrary to the conclusion of the FRFA, small cable and its customers will have to subsidize leased access users. Without a transaction cost reimbursement provision for small cable, the average implicit fee formula will "adversely affect the operation, financial condition or market development of the cable systems."

The *Second Reconsideration Order* failed to adequately consider the impact of transaction costs on small cable. The Commission should reconsider this conclusion and incorporate the change suggested below.

C. The Commission should allow small systems to charge leased access programmers for reasonable transaction costs similar to charges for technical support.

SCBA originally proposed allowing small cable operators to charge at least \$1,000 for transactions costs per leased access contract.¹⁷ Similarly, SCBA proposed that small cable operators could require a \$500 deposit before acting on any leased access request.¹⁸ The Commission disagreed with both of these proposals.¹⁹ SCBA reiterates its recommendations for these rules as reasonable means to address the disparate impact on small cable of leased access transaction costs.

In light of the Commission reluctance to incorporate these specific proposals, SCBA recommends an alternative. As with costs for technical support, the Commission could permit all qualifying small cable operators to request reimbursement for reasonable

¹⁷ SCBA Comments, p. 18.

¹⁸ SCBA Comments, p. 29.

¹⁹ *Second Order on Reconsideration*, ¶¶ 134, 158.

transaction costs.

The Commission could adjust 47 C.F.R § 76.971 by adding a new subparagraph (i) as follows:

Operators of systems subject to small system relief may require leased access users to reimburse the reasonable transaction costs of negotiating and documenting the leased access agreement. A leased access user who alleges that a transaction cost reimbursement sought by a small system is unreasonable in light of the facts of the particular transaction may file a petition for relief under Section 76.975.

This adjustment to the leased access rules will minimize regulatory compliance burdens on small cable consistent with the purpose of 47 U.S.C. § 532.

This rule follows the same rationale underlying reimbursement for technical support: small systems and their customers should not be forced to subsidize leased access users. As with technical support reimbursement, a small operator's charge to the leased access user would remain subject to a standard of reasonableness within specific limits to emerge from contested cases. This will provide a far more flexible and preferable regulatory framework than a blanket prohibition on small operator transaction cost reimbursement.

With this rule in place, leased access users and operators will have incentives to reach efficient and reasonable leased access agreements. Leased access users will seek to reduce costs through standardized, balanced agreements. Small systems will seek to avoid the complaint process. Standard agreements will likely emerge over time that will accommodate most situations, reducing or eliminating significant transaction costs. In the interim, small cable operators and their customers will not be forced to absorb the high per subscriber costs of negotiating and documenting a new form of highly regulated transaction.

D. Transaction costs reimbursement for small cable will not discourage leased access users.

In reconsidering the transaction cost issue, one critical point emerges from the record: no party has alleged that small cable has resisted leased access. SCBA anticipates resistance from leased access interests who will claim that small cable will use the rule to avoid leased access compliance. To the contrary, it is the leased access providers who have avoided small cable.

This returns to one fundamental principle underlying commercial leased access: Commission rules should not require a small cable operator to subsidize leased access. The Commission has recognized the higher per subscriber costs with which small cable must grapple. Leased access users seeking access to a small cable system must help support the higher cost structure and limited administrative resources of that system.

The transaction cost reimbursement rule proposed above will eliminate the transaction cost subsidy imposed on small cable under the *Second Order on Reconsideration*.

E. If the Commission disallows transaction cost reimbursement, then small systems need relief from the average implicit fee formula.

Transaction costs remain a small system issue because the average implicit fee formula will decrease leased access rates. A regulatory framework that decreases rates while increasing the costs and burdens of compliance for small systems does not work. The Commission has recognized this in the *Small System Order*. If the Commission declines to allow small systems to obtain transaction cost reimbursement, then the Commission must provide an alternative to the average implicit fee formula. For the reason discussed above, it is too low for small systems.

Form 1230 rate regulation provides an alternative framework. Qualifying small systems should be able to use the maximum permissible per channel rate from Form 1230, a rate that fully reflects a small systems' higher cost structure. From that rate, the system could deduct its average, per channel monthly programming costs. This figure would then be multiplied by the number of customers subscribing to the particular service tier. The product would represent a realistic approximation of the value of the channel and the administrative and transaction costs incurred by the small system.

SCBA believes a transaction cost reimbursement rule for small cable would more smoothly align with the existing rules. Nonetheless, if the Commission declines to adopt this adjustment, small systems should not be forced to adopt an average implicit fee structure which does not fully compensate them for the costs of leased access.

III. CONCLUSION

SCBA has raised the leased access transaction cost issue throughout this rulemaking. SCBA again returns to the Commission on this critical small cable issue. The average implicit fee formula fails to compensate small systems for the high per subscriber transaction costs of leased access transactions. The *Second Order on Reconsideration* appeared to miss the point on this issue.

Small cable and its customers should not be required to subsidize leased access users. To avoid such a subsidy, the Commission should permit qualifying small systems to require reimbursement of reasonable leased access transaction costs.

A small adjustment to 47 C.F.R. § 76.971 will accomplish this result.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Eric E. Breisach", written over a horizontal line.

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